Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

ESTATE OF BENJAMIN SHAPIRO, Deceased, SAUL A. SHAPIRO, Executor and STEPHEN SHAPIRO, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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54 pp

QUESTION PRESENTED

Does the Due Process Clause prohibit Internal Revenue Service ministerial employees from refusing to accept a taxpayer's supplemental estate tax returns in violation of clearly stated Internal Revenue Service published procedures and practice.

LIST OF PARTIES

The names of all parties to the proceedings in the Court whose judgment is sought to be reviewed here appear in the caption of the case.

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Petitioner, Estate of Benjamin Shapiro, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 111 F.3d 1010 and is reproduced in the Appendix filed herewith ("App.") at 1a. The unreported opinion (Decision) of the Tax Court in this case is reproduced at App. 22a.

STATEMENT OF JURISDICTION

The United States Court of Appeals decided the case on April 9, 1997. A petition for rehearing was denied on June 13, 1997. A copy of the order denying rehearing appears at App. 26a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

I. The pertinent provisions of the Fifth Amendment, U.S. Const. amend V, are, as follows:

> No person shall be . . . deprived of life, liberty, or property, without due process of law. . . .

II. The pertinent provisions of the Internal Revenue Code of 1954, (hereinafter "I.R.C.") § 6166, are set forth below:

6166. Extension of time for payment of estate tax where estate consists largely of interest in closely held business.

(a) 5-year deferral; 10-year installment payment.

(1) In general. If the value of an interest in a closely held business which is included in determining the gross estate of a decedent who was (at the date of his death) a citizen or resident of the Untied States exceeds 35 percent of the adjusted gross estate, the executor may elect to pay part or all of the tax imposed by § 2001 in 2 or more (but not exceeding 10) equal installments.

(2) Limitation. The maximum amount of tax which may be paid in installments under this subsection shall be an amount which bears the same ratio to the tax imposed by § 2001 (reduced by the credits against such tax) as —

(A) the closely held business amount, bears to

(B) the amount of the adjusted gross estate.

(3) Date for Payment of Installments. If an election is made under paragraph (1), the first installment shall be paid on or before the date selected by the executor which is not more than 5 years after the date prescribed by

§ 6151(a) for payment of the tax, and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed by this paragraph for payment of the preceding installment.

6166(f) Time for Payment of Interest. If the time for payment of any amount of tax has been extended under this § 6166.

> (1) Interest for first 5 years. Interest payable under § 6601 of any unpaid portion of such amount attributable to the first 5 years after the date prescribed by § 6151(a) for payment of the tax shall be paid annually.
>
> (2) Interest for periods after first 5 years. Interest payable under § 6601 on any unpaid portion of such amount attributable to any period after the 5-year period referred to in paragraph (1) shall be paid annually at the same time as, and as a part of, each installment payment of the tax.
>
> (3) Interest in the case of certain deficiencies. In the case of a deficiency to which subsection (e) applies which is assessed after the close of the 5-year period referred to in paragraph (1), interest attributable to such 5-year period, and interest assigned under paragraph (2) to any installment the date for payment of which has arrived on or before the date of the assessment of the deficiency, shall be paid upon notice and demand from the Secretary.

(4) Selection of shorter period. If the executor has selected a period shorter than 5 years under subsection (a)(3), such shorter period shall be substituted for 5 years in paragraphs (1), (2), and (3) of this subsection.

6166(g)(3) Failure to make payment of principal of interest.

(A) In general. Except as provided in subparagraph (B), if any payment of principal or interest under this Section is not paid on or before the date fixed for its payment by this section (including any extension of time), the unpaid portion of the tax payable in installments shall be paid upon notice and demand from the Secretary.

(B) Payment within 6 months. If any payment of principal of interest under this section is not paid on or before the date determined under subparagraph (A) but is paid within 6 months of such date —

(i) the provisions of subparagraph (A) shall not apply with respect to such payment,

(ii) the provisions of Section 6601(j) shall not apply with respect to the determination of interest on such payment, and

(iii) there is imposed a penalty in an amount equal to the product of —

> (I) 5 percent of the amount of such payment, multiplied by
>
> (II) the number of months (or fractions thereof) after such date and before payment is made. The penalty imposed under clause (iii) shall be treated in the same manner as a penalty imposed under subchapter B of chapter 68.

III. The pertinent provisions of Revenue Procedure 81-27, Rev. Proc. 81-27, 1981-2 C.B. 547, [reproduced at App. 28a] are set forth below:

> Section 1. Purpose
>
> > The purpose of this Revenue Procedure is to set forth the procedure to be followed by an estate when installment payments due under Sections 6166 or 6166A of the Internal Revenue Code are recomputed because of a reduction in the estate tax caused by the payment of interest on the tax due.
>
> Sec. 2. Background
>
> > .01 Estates that have elected to pay estate tax in installments under § 6166 or § 6166A of the Code may, under certain circumstances, deduct the amount of interest accruing on the installment payments as an expense of administration under § 2053(a)(2). See Estate of *Bahr v. Commissioner,* 68 T.C. 74 (1977), acq. 1978-1 C.B.1; Rev. Rul. 78-125, 1978-1 C.B. 292.

.02 Rev. Rul. 80-250, 1980-2 C.B. 278, holds that such interest is deductible only when accrued. When the interest becomes deductible and the estate claims the deduction, the estate tax is recomputed. Installments due will be computed accordingly.

.03 Claims for refund are not allowed until the underlying tax is paid in full. Claims for abatement are barred by § 6404(b) of the Code.

Sec. 3. Procedure

.01 An executor of an estate that deducts interest on an estate tax return after it is filed may file supplemental information on a Form 706, U.S. Estate Tax Return, as provided in § 20.6081-1(c) of the Estate Tax Regulations. The Form 706 should have the words "Supplemental Information" placed on the top.

.02 The supplemental Form 706 can be filed with the annual installment payment or be filed at a later date. However, the supplemental Form 706 cannot be filed before the payment of the interest for which the deduction is claimed.

.03 The supplemental Form 706 will not be considered a claim for refund or abatement. However, if the Service and the estate's representative agree to the amount of the

> overassessment as shown on the supplemental Form 706, or as adjusted by the Service, the amount of the overassessment will be abated. Thus, both the unpaid tax liability and the amount of interest accrued thereon will be reduced. Future installments due will be recalculated and any overpayment of an installment of either tax or interest will be applied to the next installment in accordance with § 6403 of the Code.
>
> .04 If the final total of the installment payments made exceeds the estate tax liability, a claim for refund or credit can be filed. Such claim must be filed on Form 843, Claim, within the applicable period of limitations set forth in § 6511 of the Code.

STATEMENT OF THE CASE

Benjamin Shapiro (the Decedent) died testate on July 2, 1986. His estate, the Petitioner, filed a federal estate tax return reporting the total amount of estate tax owed as $1,197,127.

Normally, estate tax payments are due within nine months of the decedent's death. I.R.C. Sections 6075(a), 6151(a). Where the value of a decedent's interest in a closely-held business exceeds thirty-five percent of the decedent's adjusted gross estate, however, the estate may, pursuant to I.R.C § 6166(a), elect to defer payment of the federal estate tax attributable to the value of that interest in up to ten equal installments beginning five years after the tax would otherwise be owed. A taxpayer electing to defer estate taxes pursuant to § 6166 must nonetheless make annual payments of interest on the unpaid portion of the federal estate tax liability during the deferral period. I.R.C § 6166(f).

The Petitioner elected to take advantage of the deferral provisions of § 6166 and to pay the majority of its estate tax liability in ten annual installments beginning on April 2, 1992. In arriving at a total tax liability of $1,197,127, the Petitioner claimed a credit of $460,751 under I.R.C § 2013, which section allows a credit for the federal estate tax that was paid with respect to the prior transfer of property to the decedent from a person who died in the ten years before the decedent's death. In this case, the credit sought was based on the estate tax paid on the transfer of a trust interest to the decedent from his wife upon her death.

In September 1990, the IRS issued a Notice of Deficiency in the amount of $208,540.56, attributable to the IRS's partial disallowance of the § 2013 credit. The Petitioner brought an action in the United States Tax Court pursuant to the jurisdiction conferred by I.R.C. § 7442 to determine whether the disallowance was proper. On October 20, 1993, the Tax Court found for the Petitioner, ruling that it had properly calculated the § 2013 credit. *See Estate of Shapiro v. Commissioner,* 66 T.C.M. (CCH) 1067 (1993).

Pursuant to I.R.C § 2053(a)(2), annual interest payments owing as a result of a § 6166 election are allowed as an "administration expense" deduction against the decedent's federal estate tax liability. It is not possible, however, to ascertain the amount of the annual interest expenses until these "administration expenses" actually accrue, and therefor no deduction is allowed for as yet unaccrued interest expenses. Accordingly, these deductions (which are not reflected in an electing estate's original tax return) cannot be and are not taken into account by the IRS in calculating the size of the annual interest payments and installment payments that will come due each year under the § 6166 election. However, once they are taken, the deductions affect the balance due and hence, the annual payments must necessarily be recalculated.

In 1981, the IRS promulgated Revenue Procedure 81-27, 1981-2 C.B. 547, precisely to establish a clear procedure to follow when installments need to be recomputed because of a reduction in the estate tax caused by deduction of the payment of installment interest. That Revenue Procedure allows an estate to file a supplemental return adjusting the estate's tax liability at the time at which it makes the payment of interest for which the deduction is claimed. In this manner, an estate can deduct the interest as it makes its installment payments, rather than having to wait until the end of the deferral period.

Relying on Revenue Procedure 81-27, commencing with the interest payment due April, 1989 and continuing during the pendency of its Tax Court case, commenced two years thereafter, the Petitioner utilized Rev. Proc. 81-27 and annually recomputed the amount of its estate tax liability, and hence the amount of its annual payments, to reflect the § 2053(a)(2) administration expenses as these deductions accrued. In reliance on and adhering to said Revenue Procedure, the Petitioner filed supplemental tax returns each year and paid the IRS the amount reflected therein.

However, the IRS Holtsville Service Center arbitrarily and without explanation rejected the Petitioner's supplemental tax returns, the very supplemental returns Rev. Proc. 81-27 requires in order to deduct accrued interest expenses. Instead, the Holtsville Service Center ignored Rev. Proc. 81-27 and billed the Estate as if the deductions could *not* be taken. Further, the Service Center assessed penalties and interest on the difference between the amounts it demanded and the amounts it actually received.

The Petitioner continued to make payments in accordance with the amounts owed pursuant to the provisions of IRC § 2053(a)(2) and Revenue Procedure 81-27, explaining this to

the Service Center in correspondence and communications, and it refused to pay the penalties or the additional interest demanded by the IRS.

Finally, on January 22, 1993, during the Tax Court case, the IRS informed the Petitioner that it would shortly file a Notice of a Federal Tax Lien and seize the unpaid amounts it alleged was due. Unable to turn to the United States District Court for relief because of the pendency of the Tax Court case, the Petitioner filed a Motion to Restrain the IRS's tax collection, which Motion was denied by the Tax Court because it lacked equity jurisdiction. At that point, the Petitioner, totally without recourse, was compelled to pay in full the amount that the IRS claimed it owed, plus penalties and interest. Its § 6166 election was thereby negated, and the Estate was forced substantially to overpay its estate tax liability by prepayment of such tax ten years prematurely .

When the Tax Court in October 1993 rendered its Opinion on the § 2013 credit issue, it was clear that the Petitioner had already paid to the IRS more than its total federal estate tax liability. The Tax Court therefore ordered the parties to submit computations to determine how much money the Petitioner had overpaid the IRS. Although it took the IRS nineteen months to make its mathematical computations, it finally agreed with petitioner that there had been a payment of $225,118.50 in excess of Petitioner's final total liability.

The Petitioner also requested in its Tax Court Rule 155 computation that the IRS return to it an additional $478,840.07, the amount of tax that was paid prematurely as a result of the IRS's failure to allow Petitioner to follow the procedures found in Rev. Proc. 81-27 and to recalculate what it owed as it made interest payments based on accrued administrative expense deductions under § 2053(a)(2). If the IRS had not improperly

refused to allow it to take these deductions as it went along, Petitioner would not have paid the full amount of $478,840.07 for an additional ten years. Accordingly, Petitioner demanded that the IRS return that money (with interest) and allow Petitioner to pay it later in annual installments pursuant to its § 6166 election as if such election had not been nullified by the IRS' arbitrary behavior.

By a Decision dated October 31, 1995, the Tax Court rejected Petitioner's request. (App. 22a). An appeal to the United States Court of Appeals for the Second Circuit followed.

The Second Circuit held that the matter was one of discretion and that there was no abuse of discretion by the IRS Service Center in refusing to allow Petitioner to follow the IRS' published abatement procedures. Relying on a factually incorrect affidavit of a Holtsville Service Center ministerial employee that was submitted to the Tax Court, and notwithstanding the specific provisions of Revenue Procedure 81-27 and widespread Service Center observance of that procedure, the Second Circuit incorrectly held that although the Petitioner was correct that overpayment of tax as a result of IRS compulsion (*i.e.*, premature payment) would entitle an estate to a return of its overpayment and to be restored to its § 6166 payment schedule, it was the practice of the IRS not to afford taxpayers relief under said Revenue Procedure *during the pendency* of a Tax Court case strongly because of the logistic difficulty in coordinating the activities of the various branches of the IRS.

In fact, however, the first returns were filed two years *prior* to the Tax Court case and were also rejected. In any case, the Holtsville Service Center is alone among the ten (10) national service centers in its rejection of supplemental returns filed during this period. "Administrative convenience" was therefore the rationale cited by the Second Circuit as to why the Holtsville

Service Center should be able to ignore Rev. Proc. 81-27 and reject supplemental returns filed during the pendency of a Tax Court case, thereby destroying a taxpayer's statutory right of election.

REASONS FOR GRANTING THE WRIT

The IRS wrongfully deprived Petitioner of a properly elected statutory right granted by Congress. The result was a loss to it of nearly one-half million dollars despite its compliance with every law and applicable IRS rule and regulation.

The IRS should be held to its published policies, particularly when a taxpayer relies on them. This Court has held "[w]here the rights of individuals are affected, it is incumbent upon agencies to follow their own procedures. This is so even where the internal procedures are possibly more rigorous than would otherwise be required." *United States v. Caceres*, 440 U.S. 741, 751 n.14 (1979) (*quoting Morton v. Ruiz*, 415 U.S. 199, 235 (1974)). *See also Service v. Dulles*, 354 U.S. 363, 388 (1957) (employee dismissal reversed where regulations requiring undersecretary's review not followed); *Accardi v. Shaughnessy*, 347 U.S. 260 (1954) (relief granted where deportation procedures not followed); *Massachusetts Fair Share v. Law Enforcement Assistance Adm'n*, 758 F.2d 708, 711 (D.C. Cir. 1985) ("It has long been settled that a federal agency must adhere firmly to self-adopted rules by which the interests of others are to be regulated"). Here, the right of the taxpayer affected was its ability to make an election granted by the Congress.

Rules promulgated by a federal agency which regulate the rights and interest of others, as here, are binding upon the agency. *Columbia Broadcasting System, Inc. v. United States*, 316 U.S. 407, 422, 86 L. Ed. 1563, 62 S. Ct. 1194 (1942). The Second Circuit Court of Appeals has recognized that "although the courts

have declined to review the merits of decisions made within the area of discretion delegated to administrative agencies the have insisted that where the agencies have laid down their own procedures and regulations, those procedures and regulations cannot be ignored by the agencies themselves even where discretionary decisions are involved." *Smith v. Resor,* 406 F.2d 141, 145 (2nd Cir. 1969). In *Montilla v. I.N.S.,* 926 F.2d 162 (2nd Cir. 1991) the court concluded that the rule requiring an agency to abide by its own policies and regulations is "premised on fundamental notions of fair play underlying the concept of due process," and that "its ambit is not limited to rules attaining the status of formal regulations." 926 F.2d at 167. *Accord International House v. NLRB,* 676 F.2d 906, 912 (2nd Cir. 1982). This doctrine applies "even where discretionary decisions are involved," *Smith v. Resor,* 406 F.2d at 145 (Kaufman, J.).

If permitted to stand, the Second Circuit's opinion in this case will grant license to the IRS to deny a taxpayer due process, preventing a taxpayer from claiming the benefits of Internal Revenue Code provisions (*e.g.,* the § 6166 deferral), simply by refusing on the basis of "administrative convenience" to follow its own pronounced policies. This is particularly unfair since filing annual supplemental returns is the *only* method by which an estate can deduct interest that has not accrued as of the filing of the estate's original estate tax return. The taxpayer's dilemma is enhanced when it is understood that the pendency of the Tax Court case (brought on by the IRS' improper Notice of Deficiency) deprived the taxpayer of judicial recourse and permitted the IRS wrongfully to collect these amounts through compulsion.

It is submitted that this result cannot stand. Fair play would determine that the properly electing taxpayer's congressionally granted right takes priority over the IRS' administrative convenience.

I.

THE DUE PROCESS CLAUSE PROHIBITS THE IRS FROM REFUSING TO ACCEPT PETITIONER'S SUPPLEMENTAL RETURNS IN VIOLATION OF THE IRS'S OWN POLICY.

The record in this case demonstrates that Petitioner properly invoked Revenue Procedure 81-27, first submitting supplemental returns two years prior to the Tax Court case and then annually each time it made a § 6166 payment, which thereby reduced the amount of its payments based on the interest deductions permitted by I.R.C. § 2053(a)(2) and claimed in those returns. The IRS' Holtsville Center arbitrarily refused to accept these supplemental returns, and, in so doing, it disregarded both its own procedure and IRS practice, unjustifiably forcing the Petitioner to pay $478,840.07 ten years prematurely.

The Second Circuit's approval of the IRS' violation of its own policy constitutes a denial of Petitioner's right to due process because the IRS promoted its policy, as the Second Circuit in fact found, for the specific purpose of inducing taxpayer reliance thereon. *See generally* Rev. Proc. 89-14, 1989-1 C.B. 814, at § 7.01(5). ("Taxpayer[s] generally may rely on . . . revenue procedures published in the Bulletin in determining the tax treatment of their own transactions. . . ."). [App. 19a].

In *Caceres, supra,* this Court set forth a four-pronged test for when the IRS could be freed from adherence to its published rules. There, this Court declined to suppress tape recordings which an IRS agent made of the defendant's attempt to bribe him. The recordings had been made in violation of IRS internal guidelines requiring three levels of approval before an IRS agent may tape record a meeting with a taxpayer. *See* 440 U.S. at 745-46. In *Caceres, supra,* the agent obtained only two of the three

required approvals, and the taxpayer sought thereby to prohibit their use. *Id.* at 747-48.

On those facts, this Court held that the suppression of the tape recording were not required because: (i) the IRS violation was unintentional and was the result of a reasonable good faith error; (ii) the IRS policy was not designed or publicized to induce taxpayer reliance; (iii) there was no taxpayer reliance; and (iv) the error was "purely one of form, with no discernible effect . . . on the action taken by the agency and its treatment of respondent)." 440 U.S. at 752. In *Caceres, supra,* this Court made clear that the IRS conduct "reflected a reasonable, good-faith attempt to comply" with its policy and that the violation, if one occurred, was unintended, not caused by indifference and without substantive effect. 440 U.S. at 752, 757.

In the instance case, by contrast, all four of the tests in *Caceress* are met: (i) the IRS violation was intentional and repeated even after notice; (ii) the IRS policy was designed to induce taxpayer reliance [Rev. Proc. 81-27, 1981-2. C.B. 547 and Rev. Proc. 89-14, 1989-1 C.B. 814]; (iii) taxpayer reliance resulted; and (iv) the Holtsville Service Center's arbitrary rejection of Petitioner's supplemental returns, in clear derogation of the express terms of Revenue Procedure 81-27 and IRS practice, had great substantive effect on the relying taxpayer.

Revenue Procedure 81-27, unlike the purely internal policy at issue in *Caceres, supra,* was promoted as the IRS' policy for the specific purpose of inducing taxpayer reliance. Given that the IRS promoted its policy of having estates file supplemental returns as the only method available to claim interest deductions for the purpose of inducing taxpayer reliance, Petitioner is not required to show actual reliance in order to make out a due process claim. *See, e.g., Montilla v. I.N.S.,* 926 F.2d 162 (2nd Cir. 1991); *Hammond v. Lenfest,* 398 F.2d 705 (2nd Cir. 1968).

In any event, Petitioner did, in fact, rely on the IRS policy, and it filed annual supplemental returns pursuant to the promulgated revenue procedure. Clearly, the filing of supplemental returns in accordance with Rev. Proc. 81-27 was the *only* method by which a taxpayer could claim the deductions available to it under § 6166. Accordingly, to hold that the Petitioner cannot do so based on unannounced and unknowable IRS policy amounts to government by secret law.

Finally, it cannot be disputed that Petitioner was prejudiced by the IRS' arbitrary rejection of its supplemental returns. Such arbitrary behavior cost the taxpayer over $500,000.

The Second Circuit denied Petitioner's appeal of the Tax Court's Decision as a matter of the IRS' administrative convenience. This result constitutes a denial of due process and is contrary to the decisions of this Court and the federal courts of appeal, cited above, all of which accept the principle that an individual's due process rights are violated where the individual "has reasonably relied on agency regulations promulgated for his guidance or benefit and has suffered substantially because of their violation by the Agency" *See Caceres*, 440 U.S. at 752-53.

CONCLUSION

Fundamental notions of fairness require that this Court grant the petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED APRIL 9, 1997

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 876—August Term, 1996

(Argued: February 13, 1997 Decided: April 9, 1997)

Docket No. 96-4009

ESTATE OF BENJAMIN SHAPIRO, Deceased, SAUL A. SHAPIRO, Executor, and STEPHEN SHAPIRO, Executor,

Petitioners-Appellants,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Before:

JACOBS, CALABRESI, and LAY,*

Circuit Judges.

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* The Honorable Donald P. Lay, Senior Circuit Judge of the United States Court of Appeals for the Eighth Circuit, sitting by designation.

Appendix A

The estate of Benjamin Shapiro appeals from an October 31, 1995 judgment of the United States Tax Court (L.W. Hamblen, Jr., *Chief Judge*), refusing to order the Internal Revenue Service to refund $478,840.07 in estate taxes that had allegedly been paid prematurely by the estate.

Affirmed.

MYRON S. SCHULMAN, Scarsdale, N.Y. (Bernard S. Mark, Richard S. Kestenbaum, Kestenbaum & Mark, Great Neck, N.Y., of counsel), *for Petitioners-Appellants.*

DAVID ENGLISH CARMACK, Tax Division, United States Department of Justice, Washington, D.C. (Loretta C. Argrett, Assistant Attorney General, Pamela C. Berry, Tax Division, of Counsel), *for Respondent-Appellee.*

CALABRESI, *Circuit Judge*:

In *Estate of Bell v. Commissioner*, 928 F.2d 901, 903-04 (9th Cir. 1991), the Ninth Circuit held that if a taxpayer, who has elected to defer estate tax liability pursuant to I.R.C. § 6166, overpays an installment of that tax, the amount of the overpayment will be credited against future installments rather than refunded to the taxpayer. Relying on *Estate of Bell*, the Tax Court in the case before us refused the taxpayer's request for a refund

of its alleged overpayments. It is possible that the Tax Court placed more weight on *Estate of Bell* than that decision can safely bear. Nonetheless, since we find that the taxpayer did not, in fact, overpay its installments, we affirm the Tax Court's decision without reaching the issue.

BACKGROUND

Benjamin Shapiro (the decedent) died testate on July 2, 1986. His estate, the petitioner-appellant in this case ("the Estate"), filed a tax return reporting the total amount of estate tax owed as $1,197,127.

Normally, estate tax payments are due within nine months of the decedent's death. *See* I.R.C. §§ 6075(a), 6151(a). Where the value of a decedent's interest in a closely-held business exceeds 35% of the decedent's adjusted gross estate, however, the estate may, pursuant to I.R.C. § 6166(a), elect to defer payment of the federal estate tax attributable to the value of that interest.[1] Section 6166 allows the estate to pay the portion of the estate tax attributable to the interest in the closely-held business in up to ten equal installments beginning five years after the tax would otherwise be owed. A taxpayer electing to defer estate taxes pursuant to § 6166 must nonetheless make annual payments of interest on the unpaid portion of the federal estate tax liability during the deferral period. I.R.C. § 6166(f). When the taxpayer fails to make such interest or installment payments, the Internal Revenue Service (the "IRS") may demand payment of the full unpaid portion of the deferred estate tax liability. I.R.C. § 6166(g)(3).

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[1] "The purpose of section 6166 is to prevent the forced liquidation of closely held businesses because substantial estate taxes must be paid." *Estate of Bell*, 928 F.2d at 902.

Appendix A

Since Shapiro's interest in his closely-held business, Benjamin Shapiro Realty Co., represented 95% of the adjusted gross estate, the Estate elected to take advantage of the deferral provisions of § 6166 and to pay the vast majority of its estate tax liability in 10 annual installments beginning on April 2, 1992.

In arriving at a total tax liability of $1,197,127, the Estate claimed a credit of $460,751 under I.R.C. § 2013. That section allows a credit for the federal estate tax that was paid with respect to the prior transfer of property to the decedent from a person who died in the ten years before the decedent's death.[2] In this case, the credit sought was based on the estate tax paid on the transfer of a trust interest to Shapiro from his wife upon her death. In September 1990, the IRS issued a statutory notice of deficiency in the amount of $208,540.56. This deficiency was attributable to the IRS's partial disallowance of the § 2013 credit. The Estate brought an action in the Tax Court to determine whether that disallowance was proper. On October 20, 1993, the Tax Court found for the Estate, ruling that it had properly calculated the § 2013 credit. *See Estate of Shapiro v. Commissioner*, 66 T.C.M. (CCH) 1067 (1993).

In the meantime, however, the IRS had been demanding interest payments and, later, installment payments on the deferred estate tax. The Estate made these payments, but in amounts less than the IRS had sought. The Estate arrived at these lower amounts on the following theory.

Pursuant to I.R.C. § 2053(a)(2), annual interest payments owing as a result of a § 6166 election are allowed

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[2] The credit is calculated by a complicated process that takes into account, among other things, the length of time between the transferor's death and the decedent's death.

as an "administration expense" deduction against the decedent's federal estate tax liability. *See* Rev. Rul. 78-125, 1978-1 C.B. 292; *Estate of Bahr v. Commissioner*, 68 T.C. 74 (1977), *acq.* 1978-1 C.B. 1. Since, however, it is not possible to ascertain the amount of the annual interest expenses until these "administration expenses" actually accrue, no deduction is allowed for as yet unaccrued interest expenses. *See Estate of Bailly v. Commissioner*, 81 T.C. 246, 252, *modified*, 81 T.C. 949 (1983). Accordingly, these deductions, which are not reflected in the estate's original tax return, are not taken into account by the IRS in calculating the size of the annual interest payments and installment payments that will come due each year under the § 6166 election. Relying on Revenue Procedure 81-27, 1981-2 C.B. 547,[3] the Estate believed that it was allowed to recompute the amount of its estate tax liability, and hence of its annual payments, to reflect the § 2053(a)(2) administrative expenses as these deductions accrued. It did so unilaterally, and, as a result, paid the IRS less than the amounts billed.

Refusing to accept the Estate's supplemental tax returns, which took into account deductions for these accrued interest expenses, the IRS assessed penalties and interest on the difference between the amounts it demanded and the amounts it actually received. The Estate continued to make payments in accordance with the amounts that it believed it owed, and refused to pay those penalties or that additional interest.

Finally, on January 22, 1993, the IRS informed the Estate that it was planning to file notice of a Federal tax lien to seize the unpaid amounts. When the Estate's

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[3] This Revenue Procedure is discussed in Part II, *infra*.

motion to restrain the IRS's tax collection was denied by the Tax Court, the Estate gave in and paid in full the amount that the IRS claimed it owed, including all past due amounts, plus penalties and interest thereon.

Later that year, however, when the Tax Court rendered its decision on the § 2013 credit issue, it became clear that the Estate had already paid to the IRS more than its total federal estate tax liability. The Tax Court therefore ordered the parties to submit Rule 155 computations to determine how much money the Estate had overpaid the IRS.[4] Both parties agreed that there had been a payment of $225,118.50 in excess of the Estate's final total tax liability, and the IRS refunded that amount to the Estate.

But the Estate also requested in its Rule 155 computation that the IRS return to it an additional $478,840.07, the sum that it claims represents taxes that would ultimately be payable, but that it had paid prematurely as a result of the IRS's failure to allow it to recalculate what it owed as it made interest payments, and hence accrued administrative expense deductions under § 2053(a)(2).[5] According to the Estate, if the IRS had not improperly refused to allow it to take these deductions as it went along, the Estate would not yet have paid the $478,840.07. The Estate therefore demanded that the IRS return that money (with interest) and allow the

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[4] Tax Court Rule 155 establishes the procedure by which the parties determine the financial implications of a Tax Court decision. Each party submits its own calculations, and, if there is a discrepancy, the court resolves it. *See* Tax Ct. R. 155; *LeFever v. Commissioner*, 100 F.3d 778, 791 n.6 (10th Cir. 1996).

[5] There is no dispute that the Estate was eventually given the deductions to which it was entitled under § 2053(a)(2). The Estate's argument is that it should have been given those deductions at the time that it made its interest and installment payments, thereby reducing the size of these payments.

Estate to pay it later in annual installments, pursuant to its § 6166 election.

On October 31, 1995, the Tax Court rejected the Estate's request:

> Petitioner's argument that the Court should order respondent to return the estate tax that petitioner characterizes as having been prematurely paid is in direct conflict with this Court's holding in *Estate of Bell v. Commissioner*, 92 T.C. 714 (1989), *aff'd*, 928 F.2d 901 (9th Cir. 1991). In short, *Estate of Bell* stands for the proposition that, consistent with the plain language of [I.R.C. §] 6403, an overpayment of an estate tax installment payment under section 6166(a) shall be credited against any unpaid installments. In the instant case, respondent credited all of petitioner's overpayments to unpaid estate tax installments leaving an overpayment of $225,118.50. We find *Estate of Bell* to be controlling under the circumstances presented, and, therefore, we reject petitioner's proposed decision.

This appeal followed.

DISCUSSION

Since the questions presented in this case are ones of law, our review is *de novo*. *See, e.g.*, *E. Norman Peterson Marital Trust v. Commissioner*, 78 F.3d 795, 797 (2d Cir. 1996) ("We review the Tax Court's legal conclusions *de novo*.").

This case poses two distinct questions. The first is whether the Estate is correct that it should have been permitted to recalculate its estate tax liability, and thus reduce its periodic payments, to take into account the

interest deductions provided for in § 2053(a)(2) as the interest accrued. The second is whether, if the Estate was improperly denied its right to do this, its "overpayments" should now be returned to it, with interest, so that it may repay them over time pursuant to § 6166. Because the Tax Court found against the Estate on the second question, it did not reach the first one. We believe that the second issue may be more complicated than the Tax Court implied. Nonetheless, because we find against the Estate on the first issue, we affirm the Tax Court's decision.

We begin with the second issue.

I. Refund of alleged overpayments

Under I.R.C. § 6402, a taxpayer that overpays a federal tax liability may obtain a credit against any other federal tax liability or a refund of the overpayment through the filing of an administrative claim. However, I.R.C. § 6403 qualifies that provision by providing:

> In the case of a tax payable in installments, if the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the overpayment shall be credited or refunded as provided in section 6402.

In *Estate of Bell v. Commissioner*, 928 F.2d 901, 903 (9th Cir. 1991), the Ninth Circuit held that "[s]ection 6403 is clear and unambiguous; it applies to 'a tax

payable in installments.' Section 6166 deferred payments are clearly taxes payable in installments." The Ninth Circuit therefore rejected the estate's claim that it "had the privilege" to receive a refund of its overpayments and "continue deferring [its] estate taxes as though the proper tax liability had been determined at the outset." *Id.* at 902.

While the IRS contends that *Estate of Bell* governs this case, the Estate attempts to distinguish it on factual grounds. Specifically, *Estate of Bell* was a case in which the estate apparently made the overpayments voluntarily, based on its own miscalculation of the estate taxes due, whereas in the instant case the Estate made payments in excess of what it considered to be the correct amount only because the IRS threatened to penalize it, cancel its § 6166 election, and seize its assets.

The IRS argues that this is a distinction without a difference. Whether or not the IRS is correct is not clear. Even if the taxpayer is not permitted to obtain an immediate refund when it miscalculates the amount of an installment payment or makes a *voluntary or erroneous* overpayment, it does not necessarily follow that the IRS is entitled to *force* installment payments in excess of what is actually due, thereby eviscerating the taxpayer's statutory prerogative to defer payment. Three district court decisions provide strong support for this position, which is, in effect, the voluntariness distinction advocated by the Estate.

In *Snyder v. United States*, 630 F. Supp. 182 (D. Md. 1986), the taxpayer elected to defer payment under § 6166. After an audit, the IRS increased the value of certain stock and assessed a large deficiency. The taxpayer paid the deficiency immediately, but under protest,

and then brought suit for a refund. Based on a favorable jury verdict as to the value of the stock, the district court determined that the taxpayer had overpaid the government, and entered a judgment for the amount of the overpayment. Rather than refunding this amount to the taxpayer, however, the IRS credited it against the unpaid installments of estate tax liability, pursuant to § 6403. The district court disallowed this. According to the court, "[s]ection 6166 creates a very valuable right for taxpayers." *Id.* at 184. And "[i]f the judgment were to be credited to the deferred tax liability, this would have the effect of nullifying the benefits of deferred payments under § 6166. It is inconceivable that Congress intended such a result." *Id.* at 185. The court explained that it was "painfully concerned with the inherent injustice of the government's position," and refused to adopt it. *Id.*

In *Eichheim v. United States*, No. 86-M-1872, 1988 WL 123832 (D. Colo. Mar. 28, 1988), the IRS wrongly terminated the taxpayer's § 6166 election and demanded payment of the full amount of the taxpayer's estate tax liability. The taxpayer borrowed the money, paid the government, and then sued for a refund. The government admitted that it had been wrong in terminating the § 6166 election and in demanding the premature payment of the outstanding installments. Nonetheless, it argued that the overpayment should be construed as a credit against the future installments under § 6403, and therefore that no reimbursement was necessary. The district court characterized this argument as "specious," and held that, "[s]ince the payment was not an overpayment willingly made at the option of the taxpayer, but, instead, was made as the result of an erroneous demand on the part of the IRS," § 6403 did not apply. *Id.* at *3.

Gettysburg Nat'l Bank v. United States, No. 1:CV-90-1697, 1992 WL 472022 (M.D. Pa. July 17, 1992), was another case in which the IRS wrongly terminated the taxpayer's § 6166 election. In that case, the taxpayer paid the entire amount of the estate tax, and then sued for a refund. Relying on *Eichheim*, the district court held "that Plaintiff's § 6166 election was valid, and is deserving of a refund and the opportunity to pay its tax debt in installments pursuant to that statute." *Id.* at *12.

In each of these cases, the overpayment was caused by the IRS's wrongful assessment, not by the taxpayer's erroneous valuation or calculation. The taxpayer paid the tax prematurely, but only under protest. In all three cases, the district court granted a refund, rather than a credit against future installment payments.

It should be noted, however, that two of these cases, *Snyder* and *Eichheim*, pre-date *Estate of Bell*, while the third, *Gettysburg National Bank*, neglects to mention *Estate of Bell* at all. And the Tax Court in *Estate of Bell* explicitly disagreed with *Snyder* and *Eichheim*. *See Estate of Bell*, 92 T.C. at 727 ("The Executrix cites two cases as authority for her interpretation of sections 6166 and 6403: [*Snyder* and *Eichheim*]. With respect to both cases, however, we respectfully decline to agree with such Courts' interpretations of Congress' intent under section 6403."). Nonetheless, it does not necessarily follow that these district court cases are refuted altogether by *Estate of Bell*. To the extent that *Snyder* and *Eichheim* may suggest that §§ 6402 and 6403 have no application whatsoever to overpayments of installments made pursuant to § 6166, *see Snyder*, 630 F. Supp. at 184; *Eichheim*, 1988 WL 123832, at *3, they do not accurately state the law. But to the extent that those cases were premised on the notion that the government may not nul-

lify a taxpayer's right to a § 6166 election by forcing the wrongful premature payment of estate taxes, they may remain unaffected by *Estate of Bell*.

These district court cases could, in fact, be reconciled with *Estate of Bell* by drawing out the distinction that may be implicit in all of these holdings: when the overpayment of a § 6166 installment is voluntarily made (*e.g.*, is the result of a mistake on the part of the taxpayer), it will be credited against outstanding installments under § 6403, but when the overpayment is both the result of erroneous or wrongful conduct on the part of the government and made under protest by the taxpayer, it will be refunded to the taxpayer in order to preserve the taxpayer's statutory right to defer payment under § 6166.[6]

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[6] This interpretation does not appear to be at odds with the history of § 6403. That section has its roots in *Blair v. United States* ex rel. *Birkenstock*, 271 U.S. 348 (1926). In that case, the Supreme Court rejected the argument that a taxpayer who had been permitted to pay an income tax in four equal quarterly installments, each of which proved to be too high, was entitled, in receiving a refund, to have the interest on the excess of each quarterly payment run from the date that the payment was made. The Court ruled instead that the interest on the overpayment would run only from the point at which the taxpayer's total payments for the year exceeded its total liability for the year. Prior to that time, there had merely been "an advance payment of later instalments," and not "a tax erroneously or illegally assessed or collected." *Id.* at 353 (internal quotation marks omitted).

It is not easy to tell from the *Birkenstock* case whether the original overpayment resulted from an error by the taxpayer or the government. The D.C. Circuit opinion in *Birkenstock* notes that the taxpayer "filed a claim with the Commissioner, alleging that the *assessment* was excessive, and claiming a refund." *Blair v. United States* ex rel. *Birkenstock*, 6 F.2d 679, 680 (D.C. Cir. 1925) (emphasis added). This might suggest that it was the United States that originally arrived at the excessive figure. But in any event, the Supreme Court opinion notes that the taxpayer "paid without protest" the original excessive amount. *Birkenstock*, 271 U.S. at 349. Thus, regardless of who was responsible for the erroneous calculation, the taxpayer paid the tax voluntarily.

This distinction has the advantages of 1) preserving the holdings of *Estate of Bell* and *Birkenstock* without overruling *Snyder*, *Eichheim*, and *Gettysburg National Bank* and hence 2) not allowing the IRS, simply by wrongly over-assessing the estate or improperly terminating a § 6166 election, to eviscerate a taxpayer's statutory prerogative to defer payment, thereby undermining Congress' intent in enacting § 6166. On the other hand, it faces a difficult textual hurdle. Section 6403 makes no mention of such a distinction, and on its face appears to apply to any overpayment of an installment due under a § 6166 deferral plan. The question is therefore this: does the word "paid," as used in § 6403, imply a degree of voluntariness or does it apply as well to any compelled transfer of moneys. *Cf. Drummond v. Maine Employment Sec. Comm.*, 173 A.2d 353, 356 (Me. 1961) ("Where a statute providing for a refund of excessive or erroneous taxes paid is general in its terms, it applies to voluntary, as well as to involuntary or compulsory, payment, or payment under protest.") (citation and internal quotation marks omitted).

We express no views on that question, or on validity of the Estate's "voluntariness" distinction more generally, since we need not decide the issue. It is true that the Estate here paid amounts in excess of what it claimed were due only under the threat of a tax lien, and hence this case would appear to be more akin to *Eichheim* and the other district court cases than to *Estate of Bell*.[7] But regardless of whether § 6403 applies to involuntary overpayments, the Estate cannot be entitled to a refund

[7] While there would doubtless be cases at the extremes that would fall squarely on one side or the other of the line, we note that the voluntariness distinction might prove difficult to administer in practice, perhaps even on facts like those here.

unless there *was* an overpayment, unless, that is, the IRS violated the Estate's rights when it refused to allow the Estate to reduce its installment payments to reflect the deductions that it was claiming under § 2053(a)(2). And on this point, we hold for the government.

II. Section 2053(a)(2) interest deductions

Should the Estate have been permitted to recalculate its estate tax liability, and thus its periodic payments, to take into account the interest deductions provided for in § 2053(a)(2)? If the IRS was *not* required to permit the Estate to do this, then the IRS did not make any erroneous calculations, there was no premature payment, and the Estate cannot now demand the right to be reimbursed in the amount of $478,840.07 in order to pay back that sum over a six-year period. We reach precisely that conclusion.

Pursuant to I.R.C. § 2053(a)(2), the annual interest payments owing as a result of a § 6166 election are allowed as a deduction against the decedent's federal estate tax liability. *See* Rev. Rul. 78-125, 1978-1 C.B. 292; *Estate of Bahr*, 68 T.C. at 83. However, no deduction is allowed until those interest expenses actually accrue. *See Estate of Bailly*, 81 T.C. at 252. In 1981, the IRS promulgated Revenue Procedure 81-27, 1981-2 C.B. 547, "to set forth the procedure to be followed by an estate when installment payments due under sections 6166 or 6166A of the Internal Revenue Code are recomputed because of a reduction in the estate tax caused by the payment of interest on the tax due." *Id.* at § 1. That Revenue Procedure allows an estate to file a supplemental return adjusting the estate's tax liability at the time at which it makes the payment of interest for which

the deduction is claimed. *See id.* at § 3.[8] In this manner, the estate can take advantage of the deduction as it makes its installment payments, rather than having to wait until the end of the deferral period.

Attempting to invoke Revenue Procedure 81-27, the Estate submitted supplemental returns each time it made a § 6166 payment, and reduced the amount of its payments to reflect the interest deductions it claimed in the returns. The IRS disregarded these returns and refused to alter the amount of its assessments. The Estate claims that the IRS erred in refusing to accept these supplemental returns, and that, by disregarding its own Revenue Procedure, the IRS unjustifiably forced the Estate to pay $478,840.07 prematurely.

According to the IRS, however, "[t]here is no mandate in the Internal Revenue Code for the abatement procedures set forth in Rev. Proc. 81-27." Rather, the IRS allows some taxpayers to invoke those procedures "[p]urely as an act of administrative grace." The IRS has a practice of not affording relief under Revenue Procedure 81-27 during the pendency of any Tax Court case because of the difficulties of coordinating the activities of the IRS Service Center with the IRS District Counsel's Office. Insofar as the abatement procedures are an act of "administrative grace," the IRS claims to be free to follow this administratively convenient practice. For these reasons, the IRS contends that it was not required to allow the Estate to invoke Revenue Procedure 81-27. We hold that the IRS is correct, at least on the facts of this case.

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[8] The IRS and the Estate dispute whether supplemental tax returns may be filed along with an estate's interest payments during the five year interest-only period, or whether instead those supplemental returns may only accompany the payment of installments of estate tax. We need not resolve that dispute here.

Appendix A

It is well-established that, as a general rule, "the I.R.S.'s Revenue Procedures are directory not mandatory." *Estate of Jones v. Commissioner*, 795 F.2d 566, 571 (6th Cir. 1986) (citing *Cleveland Trust Co. v. United States*, 421 F.2d 475 (6th Cir. 1970)); *see also Dewberry v. United States*, 158 B.R. 979, 984 (Bankr. W.D. Mich. 1993) (pointing out "that circuit[s] have consistently held that the [IRS's] . . . Revenue Procedures are directory and not mandatory"); *Tucker v. Commissioner*, 45 T.C.M. (CCH) 1347, 1349 (1983) (stating that "procedural rules such as those set forth in various Revenue Procedures . . . are merely directory and not mandatory"). In other words, the "failure to comply with [a] Revenue [Procedure] . . . is not dispositive, as IRS procedures are mere guidelines without the force of law." *Virginia Educ. Fund v. Commissioner*, 799 F.2d 903, 904 (4th Cir. 1986); *see also United States v. Toyota of Visalia*, 772 F. Supp. 481, 486 (E.D. Cal. 1991) (Revenue Procedures do "not have the force and effect of law and thus [are] not binding on the I.R.S."), *aff'd*, 988 F.2d 126 (9th Cir. 1993); *Vosters v. United States*, No. C-88-20458-WAI, 1989 WL 90554, at *2 (N.D. Cal. June 2, 1989) ("[A]s a matter of law, the IRS's failure to follow Revenue Procedures . . . does not invalidate [a] plaintiff['s] civil tax assessment."); *Capitol Fed. Sav. & Loan Ass'n & Subsidiary v. Commissioner*, 96 T.C. 204, 217 (1991) ("Revenue procedures generally have been held to fall into [the] class of nonbinding rules, and courts have refused to invalidate the Commissioner's determinations arising out of his failure to abide by them.").

It has been noted, however, that "these cases did not purport to announce a rule applicable to all revenue procedures," and that if a Revenue Procedure "is properly

characterized as a substantive statement rather than a procedural directive," the IRS may be required to follow it in every case. *Eli Lilly & Co. v. Commissioner*, 856 F.2d 855, 865 (7th Cir. 1988). But the instances in which the IRS can be bound by its own Revenue Procedures appear to be quite rare. Courts have "established a two part test for determining whether a published rule has the force and effect of law." *Ward v. Commissioner*, 784 F.2d 1424, 1430 (9th Cir. 1986). The IRS will be bound by a published rule if 1) the rule "prescribes substantive rules—*not* interpretive rules, general statements of policy or rules of agency organization, procedure or practice, and 2) the agency promulgated the rules pursuant to a specific statutory grant of authority and in conformance with the procedural requirements imposed by Congress." *Id.* at 1430-31 (citations, brackets, and internal quotation marks omitted).

A Revenue Procedure will ordinarily not be binding under this test, since it "is a procedural rule promulgated by the Commissioner of the IRS without need of approval from the Secretary of the Treasury. As such it is not considered as a rule which confers rights upon taxpayers but rather is a mere internal procedural guide and is not mandatory." *Noske v. United States*, Nos. 6-97-399, 6-87-400, 1988 WL 146612, at *1 (D. Minn. Oct. 18, 1988). *Compare* 26 C.F.R. § 601.601(d)(2)(i)(*b*) ("A 'Revenue Procedure' is a statement of *procedure* . . . .") (emphasis added), *with id.* § 601.601(d)(ii)(v)(*a*) ("[C]ommunications involving *substantive* tax law . . . are published in the form of Revenue *Rulings*.") (emphasis added). *Cf. Boulez v. Commissioner*, 810 F.2d 209, 215 (D.C. Cir. 1987) (IRS's Statement of Procedural Rules is not binding, as it concerns matters of procedure and is "[i]ssued by the Commissioner, without

need for approval by the Secretary"); *Cataldo v. Commissioner*, 499 F.2d 550 (2d Cir. 1974) (per curiam), *aff'g* 60 T.C. 522 (1973) (same).

Revenue Procedure 81-27, by its own terms, was enacted "to set forth the *procedure* to be followed by an estate when installment payments due under sections 6166 or 6166A of the Internal Revenue Code are recomputed because of a reduction in the estate tax caused by the payment of interest on the tax due." Rev. Proc. 81-27, 1981-2 C.B. 547, at § 1 (emphasis added). It is clearly a procedural rule promulgated by the Commissioner of Internal Revenue, and does not need approval by the Secretary of the Treasury. We therefore conclude that the IRS is not required to follow Revenue Procedure 81-27.

This does not, however, end our inquiry. Even when the IRS is not bound to follow a published procedural rule, such as a Revenue Procedure, "an abuse of discretion can occur where the Commissioner fails to observe self-imposed limits upon the exercise of his discretion, provided he has invited reliance upon such limitations." *Capital Fed. Sav. and Loan*, 96 T.C. at 217.[9] Revenue Procedure 81-27 "set[s] forth the procedure to be followed by an estate." Rev. Proc. 81-27, 1981-2 C.B. 547, at § 1. As such, it invites taxpayers to rely on it, and

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[9] This rule

> affects only pronouncements regarding the exercise of discretion where the Commissioner invites reliance or where reliance is reasonable under the circumstances. Statements concerning the exercise of discretion which are issued solely for the guidance of the Commissioner's agents and employees, and which are not intended to be relied upon by the public in conducting its affairs, have not been and continue not to be binding on the Commissioner.

Id. at 219-20.

implies that the IRS will permit taxpayers to do so. *See generally* Rev. Proc. 89-14, 1989-1 C.B. 814, at § 7.01(5) ("Taxpayer[s] generally may rely upon . . . revenue procedures published in the Bulletin in determining the tax treatment of their own transactions . . . .").

Accordingly, we must review the IRS's decision not to allow the Estate to invoke Revenue Procedure 81-27 for abuse of discretion. *Cf. Capitol Fed. Sav. & Loan*, 96 T.C. at 219 ("[W]e find that the Commissioner promulgated Rev. Proc. 80-51 with the intention that taxpayers would rely upon its terms. We therefore hold that a refusal to process an application for accounting method change in accordance with the terms of Rev. Proc. 80-51 is reviewable by this Court to ascertain whether respondent has abused his discretion."); *Barnett Banks of Florida, Inc. v. Commissioner*, 106 T.C. 103, 117 (1996) ("We conclude that here respondent has abused her discretion in denying petitioner the use of Rev. Proc. 71-21."). To prevail, the Estate must show that, in the case before us, the IRS's refusal to accept and process the supplemental returns "was arbitrary, capricious, and without basis in fact." *Capitol Fed. Sav. & Loan*, 96 T.C. at 223.

We find that no abuse was present here. According to both an affidavit submitted to the Tax Court and the IRS's brief on appeal, it is the practice of the IRS not to afford taxpayers relief under Revenue Procedure 81-27 during the pendency of a Tax Court case because of the difficulty in coordinating the activities of various branches of the IRS, and because the ultimate amount of estate tax liability inevitably remains in serious question during that pendency. This is a reasonable policy. It makes little sense to allow a taxpayer to supplement its

estate tax return under an administrative abatement procedure that is not mandated by the Internal Revenue Code or the Treasury Regulations when the amount of liability is in genuine dispute.[10] In those situations, the proper amount of the interest deductions cannot be established with certainty until the resolution of the Tax Court proceeding. And it would greatly complicate matters to allow taxpayers to attempt to take those indeterminate deductions, prematurely, before the case is resolved.

Because the IRS has abided by a reasonable—albeit unpublished—policy, the Commissioner did not abuse her discretion in refusing to allow the Estate to invoke Revenue Procedure 81-27. Accordingly, the Estate had no right to recalculate its estate tax liability as it made its annual interest and installment payments to reflect its deductions for accrued interest expenses under § 2053(a)(2). The Estate was properly given those deductions after the § 2013 issue had been resolved by the Tax Court, but it was not entitled to take them at an earlier time. In other words, the Estate did not overpay its installments, and it was hence not wrongly forced to pay a portion of its estate taxes prematurely.

CONCLUSION

We conclude that the Tax Court may have placed too much emphasis on *Estate of Bell v. Commissioner* by failing to recognize that that case may not provide the IRS with unlimited power to nullify an estate's valuable statutory right to defer tax payment pursuant to § 6166 of the Internal Revenue Code. Nonetheless, on the facts

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[10] There is no contention in this case that the underlying dispute over the amount of the § 2013 credit was not genuine.

of this case, we find that the IRS was not bound to allow the Estate to invoke Revenue Procedure 81-27, and that the IRS did not abuse its discretion in abiding by its practice of not granting abatement under that Revenue Procedure during the pendency of a Tax Court proceeding. Accordingly, we hold that the IRS did not wrongfully demand the premature payment of taxes that were not yet owing under § 6166.

The decision of the Tax Court is therefore affirmed.

APPENDIX B — DECISION OF THE UNITED STATES TAX COURT ENTERED OCTOBER 31, 1995

UNITED STATES TAX COURT

Docket No. 28404-90

ESTATE OF BENJAMIN SHAPIRO, DECEASED, SAUL A. SHAPIRO AND STEPHEN SHAPIRO, EXECUTORS

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

By order dated August 25, 1995, the Court directed counsel for the parties to submit a Rule 155 computation and a decision in this case on or before September 25, 1995. On October 2, 1995, the Court received, and granted leave to file, separate Rule 155 computations and proposed decisions from each of the parties.

The parties' Rule 155 computations show that the parties now agree that petitioner is entitled to a decision that there is no deficiency in estate tax due from petitioner and that there is an overpayment in estate tax in the amount of $225,118.50, which amount was paid after the mailing of the notice of deficiency.

However, petitioner's proposed decision includes additional

language stating that petitioner is entitled to the return of an additional $478,840.07 purportedly representing tax prematurely paid by petitioner, which amount petitioner states it will repay to respondent over the balance of the deferral period authorized under section 6166(a). This portion of petitioner's proposed decision is explained in a cover letter that accompanied petitioner's computations. Although the letter is addressed to the Clerk of the Court, the letter has been filed as a memorandum in support of petitioner's computation for entry of decision. The letter states in pertinent part:

> In addition to the overpayment of $225,118.50, an amount with respect to which both respondent and petitioner are in agreement, petitioner maintains that it has been compelled to prematurely pay its entire tax liability in advance of the full deferral period elected on the filing of its estate tax return under threat of a revocation of its IRC Section 6166 election. Accordingly, in addition to the overpayment, petitioner seeks a return of such prematurely paid tax and maintains that it should be permitted (after the return of such prematurely paid tax) to continue paying its remaining estate tax liability for the balance of the deferral period authorized by IRC Section 6166(a).
>
> Pursuant to IRC Section 6166, the estate was liable for interest-only payments for four years beginning on April 2, 1988 and ending April 2, 1991. Beginning on April 2, 1992 the estate was obligated to pay both (i)

interest on its deferred liability and (ii) one-tenth (1/10) of the tax. Since the fourth installment payment of the tax was due on April 2, 1995, IRC Section 6166 provides that six installment payments should be remaining. Accordingly, petitioner seeks the return of $478,840.07 (60% of the tax-$794,066.78) that both petitioner and respondent agree is the correct tax, plus interest, from the date of each premature payment.

Pursuant to IRC Section 6512(b), this Court has jurisdiction to determine an overpayment. It is Petitioner's position that by ordering the return of the prematurely paid tax, the Court will restore the estate to the position it would have been in had it not been compelled, under threat of revocation of its IRC Section 6166 election, to prematurely pay the tax. Since the estate intends to deduct all future interest expense on its estate tax return, this will ultimately affect the final amount of the overpayment and thus, the Court has jurisdiction over this issue by virtue of IRC Section 7481(d).

Petitioner's argument that the Court should order respondent to return the estate tax that petitioner characterizes as having been prematurely paid is in direct conflict with this Court's holding in *Estate of Bell v. Commissioner*, 92 T.C. 714 (1989), affd. 928 F.2d 901 (9th Cir. 1991). In short, *Estate of Bell* stands for the proposition that, consistent with the plain language of

section 6403, an overpayment of an estate tax installment payment under section 6166(a) shall be credited against any unpaid installments. In the instant case, respondent credited all of petitioner's overpayments to unpaid estate tax installments leaving an overpayment of $225,118.50. We find *Estate of Bell* to be controlling under the circumstances presented, and, therefore, we reject petitioner's proposed decision.

Accordingly, pursuant to the opinion of the Court filed on October 20, 1993, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there is no deficiency in estate tax due from the petitioner, and further, that there is an overpayment in estate tax in the amount of $225,118.50, which amount was paid after the mailing of the notice of deficiency.

(Signed) L.W. Hamblen, Jr.
L.W. Hamblen, Jr.
Chief Judge

Entered: Oct 31 1995

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING FILED JUNE 13, 1997

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COUR HOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 13th day of JUNE one thousand nine hundred and ninety-seven

Present:

Hon. Jacobs

Hon. Calabresi

Hon. Lay*

CIRCUIT JUDGES,

* Hon. Donald P. Lay, U.S.C.A. for the Eighth Circuit, sitting by designation.

Appendix C

ESTATE OF BENJAMIN SHAPIRO, Deceased, SAUL A. SHAPIRO, Executor and STEPHEN SHAPIRO, Executor,

Petitioners-Appellants,

v

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

A petition for rehearing having been filed herein by Petitioners-Appellants The Estate of Benjamin Shapiro et. al.

Upon consideration thereof, it is

Ordered that said petition be and it hereby is **DENIED.**

FOR THE COURT
GEORGE LANGE III, Clerk
By: s/ Beth J. Meador
Beth J. Meador
Administrative Attorney

APPENDIX D — REVENUE PROCEDURE

Rev. Proc. 81-27, 1981-2 C.B. 548

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

(Also Part I, Sections 2053, 6166, 6166A; 20.2053-3, 20.6166-1, 20.6166A-1)

Section 1. Purpose

The purpose of this revenue Procedure is to set forth the procedure to be followed by an estate when installment payments due under sections 6166 or 6166A of the Internal Revenue Code are recomputed because of a reduction in the estate tax caused by the payment of interest on the tax due.

Sec. 2. Background

.01 Estates that have elected to pay estate tax in installments under section 6166 or 6166A of the Code may, under certain circumstances, deduct the amount of interest accruing on the installment payments as an expense of administration under section 2053 (a) (2). See Estate of Bahr v. Commissioner, 68 T.C. 74 (1977), acq. 1978-1 C.B. 1; Rev. Rul. 78-125, 1978-1 C.B. 292.

.02 Rev. Rul. 80-250, 1980-2 C.B. 278, holds that such interest is deductible only when accrued. When the interest becomes deductible and the estate claims the deduction, the estate tax is recomputed. Installments due will be computed accordingly.

Appendix D

.03 Claims for refund are not allowed until the underlying tax is paid in full. Claims for abatement are barred by section 6404(b) of the Code.

Sec. 3. Procedure

.01 An executor of an estate that deducts interest on an estate tax return after it is filed may file supplemental information on a Form 706, U.S. Estate Tax Return, as provided in section 20.6081-1 (c) of the Estate Tax Regulations. The Form 706 should have the words "Supplemental Information" placed on the top.

.02 The supplemental Form 706 can be filed with the annual installment payment or be filed at a later date. However, the supplemental Form 706 cannot be filed before the payment of the interest for which the deduction is claimed.

03. The supplemental Form 706 will not be considered a claim for refund or abatement. However, if the Service and the estate's representative agree to the amount of the overassessment as shown on the supplemental Form 706, or as adjusted by the Service, the amount of the overassessment will be abated. Thus, both the unpaid tax liability and the amount of interest accrued thereon will be reduced. Future installments due will be recalculated and any overpayment of an installment of either tax or interest will be applied to the next installment in accordance with section 6403 of the Code.

04. If the final total of the installment payments made exceeds the estate tax liability, a claim for refund or credit can be filed. Such claim must be filed on Form 843, Claim, within the applicable period of limitations set forth in section 6511 of the Code.

Appendix D

Sec. 4. Effective Date

This revenue Procedure is effective July 6, 1981, the date of its publication. However, estates may file supplemental Forms 706 with respect to interest payments made prior to that date.

(2)

Supreme Court, U.S.
FILED
NOV 18 1997
CLERK

No. 97-474

In the Supreme Court of the United States

OCTOBER TERM, 1997

ESTATE OF BENJAMIN SHAPIRO, ETC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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13 pp

QUESTION PRESENTED

Whether there was an overpayment of estate tax installments.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 111 F.3d 1010. The opinion of the Tax Court (Pet. App. 22a-25a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 9, 1997. The petition for rehearing was denied on June 13, 1997. The petition for writ of certiorari was filed on September 11, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Benjamin Shapiro died on July 2, 1986 (Pet. App. 3a). His estate, which is the petitioner in this case, filed a federal estate tax return reporting taxes owed

of $1,197,127. Full payment of those taxes was not remitted with the return (*ibid.*).

Federal estate taxes are generally due within nine months after the decedent's death. 26 U.S.C. 6075(a), 6151(a). When the value of the decedent's interest in a closely-held business exceeds 35 percent of his gross estate, however, the estate may elect under Section 6166 of the Internal Revenue Code to defer payment of the portion of the federal estate taxes attributable to that interest. 26 U.S.C. 6166. That Section permits the estate to pay this amount in ten equal annual installments, beginning five years after the tax would otherwise be due. 26 U.S.C. 6166(a). Annual payments of interest on the deferred portion of the estate tax liability are required. 26 U.S.C. 6166(f). If the estate fails to make either an installment payment or an annual interest payment within six months of the time that it is due, the Commissioner is authorized to demand full payment of the deferred liability. 26 U.S.C. 6166(g)(3). In the present case, petitioner elected under Section 6166 to defer payment of the bulk of the $1,197,127 reported due (Pet. App. 4a).

2. In September 1990, the Commissioner issued the estate a notice of deficiency in the amount of $208,540.56 (Pet. App. 4a). This resulted from the partial disallowance of a credit claimed by the estate under Section 2013 of the Internal Revenue Code, 26 U.S.C. 2013. That Section allows a credit against the federal estate tax for any payment of federal estate taxes made with respect to a transfer of property to the decedent during the ten years prior to his death. Petitioner sought review of the deficiency in Tax Court.

3. During the pendency of the Tax Court case, a further dispute arose with respect to the amounts

owed by petitioner under its Section 6166 election (Pet. App. 4a-6a). Petitioner maintained that, in order to obtain interest expense deductions for the interest that it paid pursuant to Section 6166, the estate should be permitted to recalculate for each year (i) the annual payment of interest owed on the deferred estate tax liability and (ii) the amount of its annual installment payments of tax (*ibid.*).

a. Section 2053(a)(2) of the Internal Revenue Code provides a deduction for administrative expenses in calculating the federal estate tax liability. 26 U.S.C. 2053(a)(2). Before the statute was recently amended,[1] administration expenses included the annual interest payments owed on the deferred estate tax liability. Rev. Rul. 78-125, 1978-1 C.B. 292; see also *Estate of Bahr* v. *Commissioner*, 68 T.C. 74 (1977), *acq.* 1978-1 C.B. 1. A deduction is not permitted, however, for interest expenses until those expenses accrue. *Estate of Bailly* v. *Commissioner*, 81 T.C. 246, 252, modified by 81 T.C. 949 (1983). Under the terms of Revenue Procedure 81-27, 1981-2 C.B. 548, the IRS permits, in limited circumstances, the recalculation of future installment payments of tax and annual payments of interest to account for the deduction of interest that has in fact been accrued and paid (Pet. App. 28a-30a).

b. The IRS disagreed with petitioner's recomputation of its annual payments of interest and installment payments of tax under these provisions. The

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[1] Section 503 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 852-53, amended Section 2053 to provide that, for decedents dying after December 31, 1997, interest paid on estate taxes deferred under Section 6166 will not be deductible.

IRS assessed penalties and interest against the estate based upon the difference between the amounts owed and the amounts paid (Pet. App. 5a). Petitioner refused to pay the penalties and additional interest and instead continued to make payments based upon its own calculations (*ibid.*). The IRS then notified petitioner that collection actions would be commenced unless the overdue taxes, interest, and penalties were paid (*ibid.*).

c. Petitioner then filed a motion in the pending Tax Court case to restrain the collection of the taxes, interest, and penalties (Pet. App. 5a-6a). When this motion was denied, petitioner remitted the amounts that the IRS had determined were due (*id.* at 6a).

4. On the substantive tax issue that gave rise to the litigation, the Tax Court held that petitioner had properly calculated the Section 2013 credit. *Estate of Shapiro* v. *Commissioner*, 66 T.C.M. (CCH) 1067 (1993). The Tax Court then ordered the parties to submit computations reflecting the amounts owed under the court's decision (Pet. App. 6a, 22a). The computations submitted by both parties under the court's decision reflected that petitioner had overpaid its federal estate tax liability by $225,118.50 (*id.* at 6a). The Tax Court entered judgment in accordance with these computations (*id.* at 22a-25a). The $225,118.50 overpayment was then refunded to petitioner (*id.* at 6a).

Petitioner requested the Tax Court to direct the government to return an additional sum of $478,840.07, which petitioner claimed was the amount of overpayment of the annual interest and installments of tax made pursuant to its Section 6166 election (Pet. App. 6a, 23a). The Tax Court rejected that request, pointing out that the Commissioner had

"credited all of petitioner's overpayments to unpaid estate tax installments leaving an overpayment of $225,118.50" (*id.* at 24a). The court further noted that petitioner's request was precluded by *Estate of Bell* v. *Commissioner*, 92 T.C. 714 (1989), aff'd, 928 F.2d 901 (9th Cir. 1991), which held that "consistent with the plain language of section 6403, an overpayment of an estate tax installment payment under section 6166(a) shall be credited against any unpaid installments" (Pet. App. 24a-25a).

5. The court of appeals affirmed. The court noted that two distinct issues are presented in this case and that resolution of either in favor of the Commissioner would require affirmance (Pet. App. 7a-8a):

> The first [issue] is whether the Estate is correct that it should have been permitted to recalculate its estate tax liability, and thus reduce its periodic payments, to take into account the interest deductions provided for in § 2053(a)(2) as the interest accrued. The second [issue] is whether, if the Estate was improperly denied its right to do this, its "overpayments" should now be returned to it, with interest, so that it may repay them over time pursuant to § 6166.

Although the Tax Court had resolved the case in the Commissioner's favor on the second issue, the court of appeals chose to affirm on the first issue instead (Pet. App. 14a-21a). The court of appeals noted that nothing in the Internal Revenue Code requires the IRS to recalculate the annual payments of interest and installment payments of tax owed pursuant to a Section 6166 election to give effect to the deductibility of the annual interest payments (*id.* at 14a-18a). The court of appeals recognized that, in Revenue

Procedure 81-27, the Commissioner allowed estates that had invoked the provisions of Section 6166 to recompute the tax and interest owed upon the payment of each installment. The court concluded, however, that the IRS had a practice not to afford that relief during the pendency of a case in Tax Court "because of the difficulty in coordinating the activities of various branches of the IRS, and because the ultimate amount of estate tax liability inevitably remains in serious question during that pendency" (Pet. App. 19a). The court stated that the Commissioner's policy not to afford such interim relief during the pendency of a Tax Court case was reasonable because "[i]t makes "little sense to allow a taxpayer to supplement its estate tax return under an administrative abatement procedure that is not mandated by the Internal Revenue Code or the Treasury Regulations when the amount of liability is in genuine dispute" (*id.* at 19a-20a). The court concluded (*id.* at 20a):

> Because the IRS has abided by a reasonable—albeit unpublished—policy, the Commissioner did not abuse her discretion in refusing to allow the Estate to invoke Revenue Procedure 81-27. Accordingly, the Estate had no right to recalculate its estate tax liability as it made its annual interest and installment payments to reflect its deductions for accrued interest expenses under § 2053(a)(2). The Estate was properly given those deductions after the § 2013 issue had been resolved by the Tax Court, but it was not entitled to take them at an earlier time. In other words, the Estate did not overpay its installments, and it was hence not wrongly forced to pay a portion of its estate taxes prematurely.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Because the underlying statutory provision has been amended prospectively (see note 1, *supra*), the issue presented in this case lacks recurring administrative importance. Further review is therefore not warranted.

1. Revenue Procedure 81-27 permits the recalculation of future installment payments of tax and accompanying annual payments of interest owed as a result of a Section 6166 election to account for interest already paid and accrued. As the court concluded in this case (Pet. App. 19a-20a), however, that procedure is not available when, as here, the underlying determination of the amount of tax owed is controverted in a pending Tax Court case. In that circumstance, recalculation of the amounts owed is to be made as part of the Tax Court's decree, and that is precisely what occurred in this case (Pet. App. 24a-25a). See pages 4-5, *supra*.

Petitioner disagrees with the conclusion of the court of appeals "that * * * it was the practice of the IRS not to afford taxpayers relief under said Revenue Procedure *during the pendency* of a Tax Court case" (Pet. 11). As the court emphasized, however, the record supports that conclusion and no contrary evidence exists (Pet. App. 19a). The factual contention that petitioner now raises thus lacks any foundation. Review of that factual contention is not warranted.[2]

---

[2] Petitioner also contends (Pet. 9) that it followed the procedures set forth in Rev. Proc. 81-27 in recomputing the decedent's federal estate tax liability and should therefore have been afforded the relief it sought. Under the reasoning applied

2. Petitioner also errs in contending that the decision in this case conflicts with decisions of this Court and of other courts of appeals. Petitioner cites a number of decisions for the proposition that the agency should be required to follow its own procedures (Pet. 12-16). As the court of appeals held in this case, however, the agency *was* following its own procedures (Pet. App. 21a). That holding of the court of appeals does not conflict with any of the decisions that petitioner cites.[3]

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by the court of appeals, it was not necessary to address this assertion—and the court did not do so. Petitioner's claim is, in any event, erroneous. Rev. Proc. 81-27 does not permit an estate to recompute unilaterally the annual interest payments and installment payments of tax that are owed pursuant to a Section 6166 election. Instead, it simply provides that the estate may supply information to be used by the IRS in determining the amount of any reduction in the estate's federal estate tax liability and any correlative reduction in annual payments of interest and installment payments of tax. The procedures set forth in Rev. Proc. 81-27 are available to an estate only after it begins to make installment payments of tax with respect to its Section 6166 election. They do not apply during the five-year period that precedes the time when the first installment payment of tax is owed. Rev. Proc. 82-120, 1982-1 C.B. 203. By the time relief under Rev. Proc. 81-27 could have been available, petitioner had already filed its petition in the Tax Court and relief was unavailable for that reason (Pet. App. 21a).

[3] Moreover, as the Tax Court concluded, petitioner in fact received a refund of the only overpayments of tax made by the estate. An overpayment occurs only when the entire amount of tax due has been overpaid, not when a single installment payment is too great. 26 U.S.C. 6403. The Tax Court correctly determined that, to the extent that petitioner's installment payments of tax and interest were excessive, the IRS properly credited these amounts against unpaid installments of tax (Pet. App. 25a).

3. The decision in this case lacks recurring administrative importance. Only the estates of decedents who die before January 1, 1998, can be affected by this decision. For decedents who die after December 31, 1997, interest paid on estate taxes deferred under Section 6166 will no longer be deductible. See note 1, *supra*.[4]

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[4] Even with respect to estates of decedents who die before January 1, 1988, this decision has little administrative importance. Only those estates eligible to elect deferral of federal estate taxes under Section 6166 *could* be affected by this decision. And, of that small group of estates, only those that have failed to comply with the terms of Rev. Proc. 81-27 and that are also involved in Tax Court litigation *are* affected by this decision.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1997